In the Supreme Court
OF THE
United States

OCTOBER TERM, 1944

SEP 12 1944
CHARLES ELMORE

No. 460

323US#1
ACM-ARM

ACME BREWING CO. (a corporation),
Petitioner,

vs.

CLIFFORD C. ANGLIM, Collector of Internal Revenue for the First District of California,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

THEODORE J. ROCHE,
Mills Tower, San Francisco,
Attorney for Petitioner.

NORMAN A. EISNER,
Mills Building, San Francisco,
Of Counsel.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

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No.

ACME BREWING CO. (a corporation),
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vs.

CLIFFORD C. ANGLIM, Collector of Internal Revenue for the First District of California,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and to the Honorable Owen J. Roberts, Hugo L. Black, Stanley Reed, Felix Frankfurter, William O. Douglas, Frank Murphy, Robert H. Jackson and Wiley Rutledge, Associate Justices of the Supreme Court of the United States:

The petitioner, Acme Brewing Co., respectfully prays that a writ of certiorari issue to review a decision of the United States Circuit Court of Appeals

for the Ninth Circuit, rendered on the 26th day of June, 1944, and which become final on the 11th day of August, 1944. The application is under Section 240 of the Judicial Code (28 U.S.C.A. 347). The action is No. 10,588 (C.C.A. 9th Cir.) and is entitled Clifford C. Anglim, Collector of Internal Revenue for the First District of California, Appellant, v. Acme Brewing Co., a corporation, Appellee.

SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED.

In December, 1934, Acme Brewing Co. (formerly known as California Brewing Association of Southern California and for convenience hereinafter referred to as "taxpayer") had a brewery under construction in Los Angeles, the completion of which it was unable to finance. (R. 39-42.) The situation was desperate, orders for machinery were cancelled, work was stopped, extensions were obtained from creditors, efforts to obtain funds from all lending sources were fruitless.

Taxpayer had only common stock authorized and outstanding of which 80% was owned by Cereal Products Refining Corporation (later known as Acme Breweries and for convenience hereinafter referred to as "Cereal") and 20% by Bohemian Distributing Co. Neither Cereal nor taxpayer has ever owned any stock of Bohemian and Bohemian has never owned any stock of Cereal. Under date of December 13, 1934, Cereal and Bohemian entered into a contract in writ-

ing to supply taxpayer with an additional $450,000.00 with which to complete its plant, and in addition thereto to supply it with bottles and cases. (R. 44.)

The two stockholders agreed to purchase certain amounts of additional common stock, Cereal agreed to accept common stock in satisfaction of prior indebtedness, and in addition agreed to lend taxpayer $350,000.00 upon its promissory note payable in five annual installments, the first to be due March 1, 1936. The note was to be secured by a deed of trust and chattel mortgage from taxpayer. With respect to this loan, the agreement expressly provided that:

> "It is understood that the California Brewing Association of California shall not pay any dividends to stockholders until said loan of $350,000.00 is entirely liquidated, together with all accrued interest."

The benefits and provisions of this agreement were fully and completely accepted and performed by taxpayer in 1934 and 1935, and long prior to May 1, 1936. The loan of $350,000.00 (increased to $400,000.00 to take up and include a previously existing encumbrance of $50,000.00) was accepted and note, deed of trust and chattel mortgage executed; the stock structure of taxpayer was altered and the stock issued for the specified consideration; bottles and cases were received according to the agreement.

Petitioner regarded itself as bound by the restriction against payment of dividends and carefully observed it. No dividends were paid except on preferred stock after express prior permission was ob-

tained from Cereal for payment of each dividend. (R. 65, 66, 70, 72, 73, 74, 76.) Permission to pay a dividend on common stock was refused by Cereal. (R. 81, 76.) The preferred stock was issued in December, 1936, to meet the need for additional capital.

The Revenue Act of 1936, Section 14, imposed what is commonly referred to as the "Undistributed Profits Tax". It imposed heavy taxes on corporations which did not distribute in dividends to stockholders all of the net income of the corporation earned during the taxable year, in excess of specified credits. One credit is set forth in Section 26(c)(1). It provides for a credit in "an amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends".

Taxpayer in its returns for 1936 and 1937 claimed the benefit of the credit. It paid an income tax for the year 1936 of $59,831.24 and for the year 1937 of $62,149.29, which amounts the Commissioner found to be correct. At the close of 1937 there still remained a balance of $240,000.00 unpaid upon the promissory note to Cereal.

The Commissioner of Internal Revenue determined that taxpayer was not liable in any amount for an undistributed profits tax for 1936 because the contract of December 13, 1934 prohibited the payment of dividends; but determined that for 1937 taxpayer was

liable for an undistributed profits tax in the sum of $71,161.15 plus interest. These determinations were made "on the ground that a contract *executed* December 13, 1934, which prohibited the payment of dividends by the corporation until a note and mortgage was paid in full, *was a legal restriction* upon the corporation for the year 1936, during which the company was indebted upon said note in the sum of $240,000.00, but that in 1937 the corporation was in a financial position to have paid said note and thereby remove the dividend restriction upon the corporation which prevented the payment of dividends for such year 1937". (R. 25.)

Thereafter, the Commissioner of Internal Revenue assessed the tax for 1937 so determined by him, plus interest, and on May 17, 1939, the taxpayer paid same in the sum of $75,997.18. Within the time provided by law claim was made for refund and action was thereafter brought to recover the money so paid. Judgment was rendered by the United States District Court in favor of taxpayer and the Trial Court expressly found that there was a written contract executed by taxpayer prior to May 1, 1936, which precluded the payment of dividends, and that the failure of taxpayer to pay the balance of $240,000.00 on the promissory note to Cereal during 1937 was fully justified by the financial condition and requirements of the Company. (R. 15.)

From this judgment the Collector appealed. On the appeal, the issue that taxpayer was in a financial condition to have paid the indebtedness during 1937 was

abandoned. Reliance was placed exclusively upon the contention that the contract in writing was not executed by taxpayer. The Circuit Court of Appeals reversed the judgment on this single ground. The issue is stated by the Circuit Court of Appeals (R. 164) as follows:

"As pointed out by taxpayer, the relief from payment of tax on undistributed profits provided for in Section 26(c)(1) requires that a contract creating the obligations which bring such section into operation shall have been executed prior to May 1, 1936, that it be in writing, that it contain a provision expressly dealing with the payment of dividends, and that it be executed by the corporation. The first three conditions are clearly met by the contract. But is the condition met that the contract must be 'executed by the corporation'?"

THE QUESTION PRESENTED.

The sole question presented is the meaning of the term "executed" contained in Section 26(c)(1) of the Revenue Act of 1936. Does a contract have to be signed by a corporation in order to be executed by it, or does the term include those steps or actions by which a corporation becomes legally bound by the terms of the written contract? In this case all of the stockholders entered into a written contract for the express benefit of taxpayer. Those who signed as officers on behalf of Cereal and Bohemian were also officers and directors of taxpayer. Mr. Schuster was

president of both Cereal and taxpayer; Mr. Adams was secretary of both corporations; Mr. Foto, president of Bohemian, was vice president of taxpayer, and Mr. Vitale, secretary of Bohemian, was treasurer of taxpayer.

Taxpayer accepted the benefits of the contract and completely embraced and performed its terms. It is beyond question, and is unhesitatingly admitted by respondent, that taxpayer became *legally bound* by the restriction against payment of dividends contained in the written contract long prior to May 1, 1936.

BASIS OF JURISDICTION.

The question arises directly under the laws of the United States. This Court has jurisdiction under Section 240 of the Judicial Code, 28 U.S.C. 347.

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

The issue in this case hinges primarily on what was decided by this Court in *Northwest Steel Rolling Mills v. Commissioner,* 311 U. S. 46, 85 L. Ed. 29. That case came up from the Ninth Circuit, which had decided (110 Fed. (2d) 286) that general laws of the State of Washington restricting the payment of dividends were by implication a part of the corporate charter of taxpayer, and therefore constituted a part of a written contract executed by the corporation. In arriving at this decision, the Circuit Court of Appeals

had come to two distinct conclusions: (1) that a corporate charter is a written contract executed by a corporation, notwithstanding it is not signed by the corporation and the corporation does not come into existence until after the instrument has been signed and filed; and (2) that the general laws of the state of incorporation, although neither referred to nor mentioned in the charter, constituted a part of the executed written contract.

This Court reversed the Circuit Court of Appeals because of its second conclusion. It held that what restricted the payment of dividends was not the written contracts, but a general state law; that the statute provided a credit in the case of a restriction included in and which was a part of a written contract, but not in the case of restriction which existed only as a matter of general state law. This Court did not disagree with the conclusion that the corporate charter was a written contract executed by the corporation, nor did it disapprove of any of the several grounds upon which the Circuit Court of Appeals had based its decision in this respect.

In the opinion, however, while emphasizing the difference betwen a written contract and a state law, this Court used some language that has led to confusion and disagreement between the Circuits. A conflict exists, and it is a much debated question, whether or not this Court intended to decide that in order to constitute an executed written contract the instrument must be signed by the corporation. The following are the words that have caused the uncertainty:

> "The natural impression conveyed by the words 'written contract executed by the corporation' is that an explicit understanding has been reached, reduced to writing, *signed* and delivered. True, obligations not set out at length in a written contract may be incorporated by specific reference, or even by implication. The Congress indicated that any exempted prohibition against dividend payment must be expressly written in the executed contract. It did this by adding a precautionary clause that the granted credit can only result from a provision which 'expressly deals with the payment of dividends'."[1]

In the face of the foregoing language, the Ninth Circuit, which was reversed, has now construed the decision as holding that a written contract to be executed in accordance with the requirements of Section 26(c)(1) must be signed by the corporation.

We believe that such a conclusion is not in accord with the decision of this Court. The decision proceeds upon the assumption that a charter is an executed written contract and it is implicit that if the restriction contained in the statute had been expressly embodied in the charter, or even incorporated by reference, the judgment would not have been reversed.

In *Lehigh Structural Steel Co. v. Commissioner*, 127 Fed. (3d) 67, 69, the Circuit Court of Appeals, Third Circuit, carefully analyzes the decision of this Court in the *Northwest Steel Rolling Mills* case and holds that

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[1]Emphasis added unless otherwise expressly noted.

> "We find nothing in the opinion to warrant the argument that neither a charter nor a certificate of stock can ever be the kind of 'written contract' which is meant by Section 26(c)(1)."

In *Monarch Theatres v. Helvering,* 137 Fed. (2d) 588, 590, the Circuit Court of Appeals of the Second Circuit, in holding that a corporate resolution is a good "execution" of a written contract, had the following to say regarding the controversial language (p. 590):

> "The often quoted language of Mr. Justice Black in Helvering v. Northwest Steel Rolling Mills, supra, 311 U. S. 46, 49, 61 S. Ct. 109, 85 L. Ed. 29, was used discursively and by way of example; it is not to be understood as laying down absolute doctrine."

In *Rex-Hanover Mills Company v. The United States,* 53 Fed. Supp. 235, May 1, 1944, the Court of Claims comments on the confusion and holds that the language in the Northwest Steel Rolling Mills opinion should not be extended beyond the issue decided—that the credit is allowed in the case of restrictions provided for in written agreements and not in the case of restrictions by statute.

In *Chess & Wymond, Inc. v. Glenn,* 132 Fed. (2d) 621, the Circuit Court of Appeals of the Sixth Circuit affirmed a decision of the United States District Court for the Western District of Kentucky, 40 Fed. Supp. 666, holding that a personal letter from the president of the taxpayer to the president of a bank, and in reliance upon which money was loaned, was a written

contract executed by taxpayer within the meaning of Section 26(c)(1).

The case of *Chess & Wymond, Inc. Supp.* is relied upon by the Tax Court in *Wathen Distilling Co. v. Commissioner,* Vol. I Reports of the Tax Court of the United States, 1188, 1194-1195.

In *Yale Petroleum Company v. Commissioner,* 2 Tax Court 1039, the Tax Court had under consideration Section 26(c)(4) of the Revenue Act of 1938. That section provides a credit for indebtedness, "evidenced by a bond and note, debenture, certificate of indebtedness, mortgage or deed of trust *issued* by the corporation". The word "issued" was held to include contracts made legally binding upon the corporation though not signed by the corporation. The close analogy between "executed" and "issued" is recognized and commented upon.

In *Phebus Oil Co. v. Commissioner,* 134 Fed. (2d) 217, decided by the Fifth Circuit and cited in the opinion of the Circuit Court of Appeals in this case, the credit was denied on the ground that the provisions of an agreement entered into between those holding control of Phebus Oil Co. were not for the benefit of Phebus Oil Co., but exclusively for the benefit of the parties to the agreement. Phebus Oil Co. was used merely as an instrumentality to perform and carry out certain provisions not for its benefit, but for the benefit of others. The clear implication is that if, as in the case at bar, Phebus Oil Co. had accepted provisions for its benefit and had become bound by corresponding restrictions against payment of dividends

contained in the agreement, the credit would have been allowed. When carefully read this decision supports the interpretation of taxpayer in this case.

In *Commissioner v. Strong Mfg. Co.,* 124 Fed. (2d) 360, the Circuit Court of Appeals of the Sixth Circuit repudiated a narrow construction of Section 26(c)(2), a companion Section of 26(c)(1), which would make that section "unreasonable, capricious and discriminatory".

Masten Realty & Mining Co. v. Commissioner, 130 Fed. (2d) 1003, decision by the Eighth Circuit, also cited by the Circuit Court of Appeals in this action, is distinguishable. A letter was written to the taxpayer offering to lend money, provided dividends were not paid until the loan was repaid. No action of any kind was taken by taxpayer until *after* all loans had been made. Thereafter, the Board of Directors passed a resolution of general policy, to the effect that the company would not pay dividends until its current loans were paid. The opinion points out that the writer of the letter could by no possibility have made a loan in reliance upon the resolution. There was, moreover, a strong dissenting opinion in the *Masten* case, which we most respectfully ask this Court to consider.

In *Caroline Mills v. Commissioner,* 125 Fed. (2d) 857, a decision of the Fifth Circuit, and the only other case relied upon by the Circuit Court of Appeals in the case at bar, there was no written contract whatsoever which embodied a restriction against the payment of dividends. There was a stockholders' resolu-

tion, which referred to an oral understanding between a committee of bondholders and a committee of stockholders. There was also a strong dissenting opinion in this case and when it was before the Board of Tax Appeals, six members dissented and held the resolution to be a sufficient compliance with Section 26(c)(1).

In *Hercules Gasoline Company, Inc. v. Commissioner,* Docket No. 111,038, decided by the Tax Court on July 31, 1944, that Court construes the *Northwest Steel Mills* case as holding that a corporate charter is not an executed written contract, but at the same time comments on the conflict between the Circuits.

It is respectfully submitted that this Court should clarify this issue. If it be its decision that a corporation is not entitled to the credit provided for by Section 26(c)(1) unless it has signed the contract, that should be settled. If such be not its decision, if the language was not intended to be so restricted or limited, that should be settled. The proper construction of the federal statute presented by the issue in this case should now be clarified and the conflict between the Circuits removed. The case is undoubtedly a proper one for certiorari to issue under Rule 38 of this Court.

PRAYER.

Wherefore, petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court

to certify and send to this Court for review and determination, on a day certain to be therein named, a full and complete transcript of the record and of all the proceedings in the case entitled Acme Brewing Co., a corporation, Plaintiff and Respondent, v. Clifford C. Anglim, Collector of Internal Revenue for the First District of California, Defendant and Appellant, and being No. 10,582 of the records of said Court, to the end that said cause may be reviewed and determined by this Honorable Court as provided by the statutes of the United States, and for such other and further relief as may be proper.

Dated, San Francisco, California,
September 6, 1944.

THEODORE J. ROCHE,
Attorney for Petitioner.

NORMAN A. EISNER,
Of Counsel.